Phillip Services

Investment Opportunity

NON-CONVERTIBLE DEBENTURES OF MUTHOOT FINCORP LTD

Investment Idea: Muthoot Fincorp Ltd (MFL)

About Muthoot Fincorp Limited (MFL)

Muthoot Fincorp Limited (MFL), set up in 1997, is a non-deposit-taking, systemically-important NBFC, engaged in lending against gold jewellery. It is the flagship company of the Muthoot Pappachan Group also popularly known as the Muthoot Blue Group, which has diverse business interests such as hospitality, real estate, and power generation. MFL is largely a promoter driven company, jointly managed by Mr. Thomas John Muthoot (Group Chairman and Managing Director), Mr. Thomas George Muthoot (Director) and Mr. Thomas Muthoot (Executive Director) (all brothers)

MFL has a well-established market position in the gold loan segment with a strong network of over 3707 branches across 24 states in India. MFL is the third largest gold loan NBFC. The company's promoters have a deep understanding of the gold loan business and have been in this business for over eight decades. Over the years, the group has established a strong reputation and brand in South India, particularly Kerala and Tamil Nadu, and has an appropriate assessment and underwriting methodology, which is being constantly refined.

The assets under management (AUM) stood at 28,251.82 crore as on Sept 30, 2024 (Gold loan AUM at 25,243.40 crore (~ 89.35 % share). As on 31st Mar 2024, the total gold holding of the company was at 48.20 tonnes.

Key Reasons for Investment

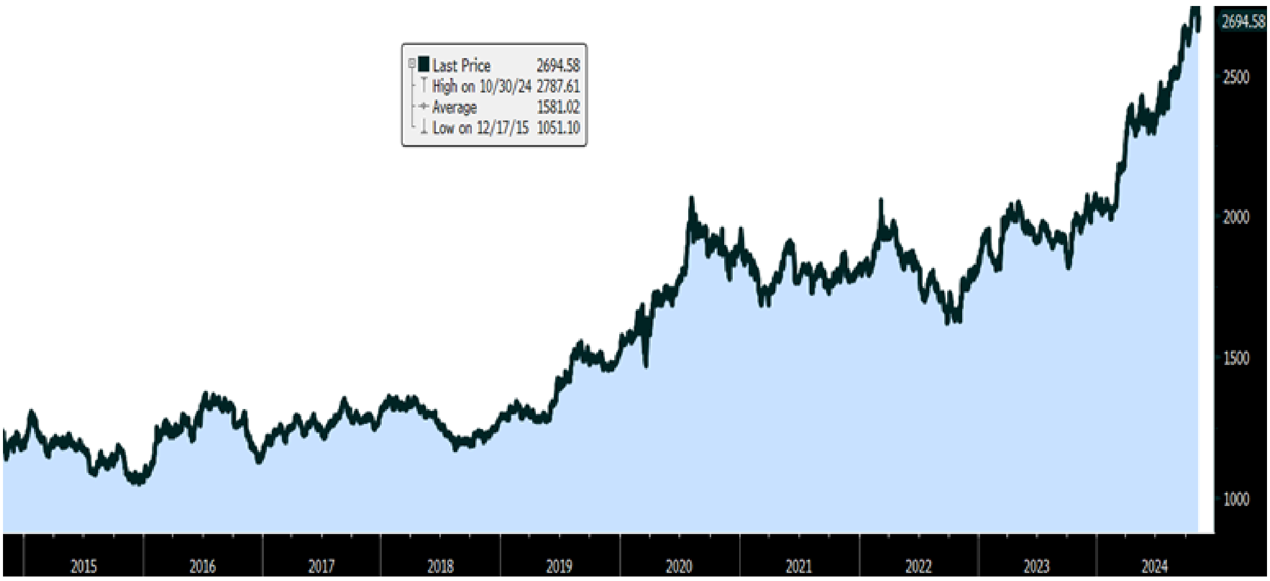
01 *Loan Collaterals*

The business model of Muthoot Fincorp Ltd (MFL) draws strength from the fact that majority of the loan book is collateralized against gold. As on 30th Sep 2024, 89.35 % of the loan book comprises loans against gold

There are a few key factors to consider here:

1. First and foremost, there is an inherent aspect of safety in gold as collateral. Gold has been a store of value since ages, even before the modern currency system came into practice. In recent times as well gold has been appreciating in value quite consistently. This trend is expected to continue, at least over the medium term due to geo-political reasons and the gradual move towards de-dollarization. Central banks all over the world are increasing exposure to the yellow metal.

Gold price movement in USD, last 10 years



(Source: Bloomberg)

2. Secondly, as compared to other secured loan segments such as auto loans, the **value of the collateral is easily ascertainable** on a day to day basis. In segment such as auto loan, the value of the security may be questionable as the underlying is a depreciating asset. Whereas the value of gold which is quality tested is unquestionable on any given day.

3.The risk of non-collateralized loans e.g. personal loans or credit card receivables is not significant as that is **not a segment the company is majorly active in**. Non-collateralized loans to MSME segment forms a very small percentage of the overall lending book (3% as on Sep 30, 2024).

4. Customers take particular care to repay loans against gold and release the asset, due to emotional attachment to family jewelry. In the unlikely case of MFL's customer not being able to repay, auctions are conducted regularly and liquidation of the asset is not much of a concern. This ensures that the loss if any to the lender is minimal.

What is noteworthy therefore to understand is that with stable to appreciating prices of the collateral and the loan amount declining due to repayments, the margin of safety on the loan against gold increases further.

- As an illustration, against gold value of say Rs. 100, if MFL advanced a loan of say Rs. 65, there is excess collateral with the company worth Rs. 35 (~54 % of the outstanding loan)
- After some repayments, the loan amount comes down to say Rs. 50 but the value of gold with MFL remains 100. In such case the excess collateral with the company goes up to Rs. 50 (100 % of the outstanding loan)
- If the price of gold increases to 110, while the loan amount comes down to Rs. 50, the value of the excess collateral with the company is worth Rs. 60 (120 % of the outstanding loan)
- If the price of gold decreases to 80, while the loan amount comes down to Rs. 50, the value of the excess collateral with the company is worth Rs. 30 (60 % of the outstanding loan).
- In such a case the company may ask the customer to provide additional collateral to increase the margin of safety.

From the regulatory front the RBI prescribes a maximum LTV(Loan to Value) of 75 % for gold loan companies at the time of disbursement. Hence, the exposure against gold is limited by regulation itself. This is another safety feature for gold loan companies.

Therefore in the current market situation where there is uncertainty around unsecured lending businesses due to multiple regulatory interventions, gold loan business is on a sound footing.

02 *Business Fundamentals*

Having established that the business model of lending against gold has significant advantages over the other lending models, we now look at the company specific data which further strengthens the investment decision in bonds of the issuer.

Economies of Scale

MFL is the 3rd largest gold loan NBFC in the country, diversified across 3,707 branches and 24 states which clearly establishes its credentials as a significant participant in the business segment. The AUM (Assets Under Management) stood at Rs 28,251.82 crore as on Sep 30, 2024 (Gold loan AUM stood at 25,243.40 crore ~ 89.35% of the book). As on March 31, 2024, the total gold holding stood at 48.20 tones. [(1)]

Seasoned Management

MFL is largely a promoter driven company who have run this business for close to 80 years and have developed a deep understanding of the gold loan business. This is evident from the strong reputation and brand recognition the group has established especially in South India, particularly Kerala and Tamil Nadu. Overall managed AUM of the group was around Rs 42,378 crore as on June 30, 2024.

Holding Structure

Stakeholder group	Holding (%)
Promoters	79.68
Angels, Family & Friends	20.32

Credit rating

CRISIL had upgraded the ratings on the perpetual bonds from A to A+ on Sep 11, 2024. The upgrade in the rating of perpetual bonds primarily factors in the higher buffer in capital adequacy above the regulatory requirement maintained by MFL in recent years.

Liquidity

As per the asset liability management statement of Sep 30, 2024, MFL, on a standalone basis, had cumulative positive gaps in the up to 5 year bucket indicating that the company is well positioned to service all its obligations comfortably. As on Sep 30, 2024, it had liquidity of Rs 1,832.26 crore (Rs 1,719.17 crore of cash and equivalent and Rs 113.09 crore of Bank Balance-other than above) (1)

Collection Efficiency

The company has demonstrated consistent collections efficiency of 95 % + with average monthly collections at around Rs. 4,530 Crs during the Q1 of fiscal 2025. Going by the past track record the collections over the next few quarters would seem adequate to meet the debt obligations. Hence liquidity position is considered as strong. [(1)]

Granular book

The Gold Loan AUM of 25,243.40 Crores held across 33.80 lacs active loan accounts making it a very granular book with average ticket size of Rs. 74,000. Gold loan business registered a steady 2.3% compound annual growth rate over fiscals 2021-2024, despite increase in competition from banks. [(1)]

Lower LTV

Average LTV of the gold loan book is 65% as on June 30, 2024 . MFL gold loan products have a tenor of 3m/6m/12m/24m/36m with interest rate ranging from 12%-27%. MFL has a minimum LTV of 50% and a maximum of 90%. The ticket size of these gold loans range between INR 10,000 and INR 10 lacs. [(1)]

03 *Financial Metrics*

Adequate Capitalization

During the Q2FY2025, CAR stood at 18.90% from 20.01% as at the end of FY24. Networth at standalone level stood at Rs 4,911 crore (including CCCPS of Rs. 150 crores) as on Sep 30, 2024, against Rs 4,423 crore as on March 31, 2024. Capitalization is further supported by low asset-side risks (security of gold jewellery, which is liquid and in the lender's possession). On a consolidated level, networth stood at Rs 6,570 crore (including CCCPS) as on March 31, 2024, against Rs 4,904 crore (adjusted for real estate and cash) as on March 31, 2023. [(1)]

Healthy Capitalization

Over the past 3 years, tier 1 and overall capital adequacy has improved on account of steady accruals from business. The company's tier-1 ratio and overall CRAR stood at 15.12% and 18.90% respectively on Sep 30, 2024, as compared to 12.1% and 16.9% respectively as on March 31, 2021. [(1)]

Healthy asset quality in the Gold Loan category even during Covid

In the gold loan segment, MFL has maintained healthy asset quality over the years, backed by strong collection efficiency, as reflected in GNPAs of 1.0-1.8% over the last five years. As on Sep 30, 2024 Gold Loan GNPA & NNPA ratios stood at 1.40% and 0.54% as compared to 0.90% and 0.44% as on 31 March 2024. [(1)]

Improving earnings profile for gold loan business

MFL's Profitability, both at consolidated and standalone level, has seen substantial improvement during last 1-2 years. On a standalone basis, RoMA (Return on Managed Assets) improved to 2.1% during fiscal 2024 (one of its highest since last 4-5 years) and further to 2.78% during Q1FY2025 as against 1.9% during fiscal 2023. If we adjust for cash and cash equivalents, profitability improves to 2.6% in Q1FY2025. The company has maintained its focus on regular interest collections in its gold loan portfolio in order to avoid for any higher delinquencies and reduce loss, if any, post auctions. [1]

Financial Performance Y-o-Y

Financial Parameter	FY2020	FY2021	FY2022	FY2023	FY2024	Q1FY2025	Q2FY2025
AUM (Cr)	14,924	18,471	18,685	18,768.46	22,866.19	25,831.53	28,251.82
Net Worth (Cr)	2,954	3,213	3,449.49	3,893	4,423.23	4,712.74	4,911
Total Income (Cr)	2,726	3,233	3,328	3491.26	4,015.77	1,244.22	1347.76
Profit after Tax (Cr)	219	369	347	459.81	562.81	181.17	198.17
Gross NPA	1.86%	1.92%	2.88%	2.11%	1.62%	1.50%	1.40%
Net NPA	0.68%	1.01%	1.57%	0.58%	0.64%	0.52%	0.54%
Tier 1	13.04%	12.09%	14.73%	16.55%	15.87%	15.60%	15.12%
Gearing	5.3	5.6	5.29	4.70	4.59	4.57	4.83
Capital Adequacy Ratio	19.56%	16.85%	21.33%	21.34%	20.01%	18.92%	18.90%
Total Debt	10,544	15,366	19,737	18,297	20,317.47	21,082.23	21,501

*Net worth 4911 Cr including CCPS as on Sep 30, 2024 (Rs. in Crore)

Key Risks for Investors

1. Geographical Concentration

Since 60 % of the business originates from southern India, there is some amount of geographical concentration risk that the company bears. The company is proactively looking to counter this risk by expanding to other regions.

2.Increase in share of Non-Gold business

The company has been looking to expand beyond the gold loan segment and this currently stands at around 10-11 % of the overall business. This will be a important aspect for investors to keep an eye on going ahead.

Key takeaway for Investors

Muthoot Fincorp Ltd. makes for a compelling investment opportunity given its sound business model based on gold backed lending. Investment risk is minimized on account of the inherent value of the collateral, sound business fundamentals and excellent financial track record.

Investors would also benefit from the attractive yields at which the securities of the issuer are currently available in the secondary market. The attractive yields coupled with the business fundamentals stand in stark contrast to other investment opportunities which lack either substantial returns or steady business performance.

With a change in interest rate cycle on the anvil, there is a strong case for booking a investment in bonds of this issuer and being able to capture the potential gains from interest rates trending lower for the next year or so.

Disclaimer

Resources:

1. Report for the quarter ended September 30, 2024 published by company